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September 24, 1982

CONFIDENTIAL
(With Secret Attachments)

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
UNITED STATES TRADE REPRESENTATIVE
DIRECTOR OF CENTRAL INTELLIGENCE
ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT

SUBJECT Senior Interdepartmental Group on International Economic Policy (SIG-IEP)

Attached are papers for the SIG-IEP meeting which will be held in the Roosevelt Room of the White House, September 28, 1982, at 1:30 PM:

Agenda Item 1 Polish Debt Situation

Agenda Item 2 Options Paper: Private Sector Initiative for Poland

Agenda Item 3 Review of Status of December 23, 1981 Allied Sanctions on Poland

Agenda Item 4 U.S.-India Economic Relations

David E. Pickford

David E. Pickford
Executive Secretary

Attachments

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Classified by S. J. Canner
Review for Declassification on 9/24/88

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Polish Debt Situation

Summary

-- During the 1970's the Poles borrowed heavily from the west in an effort to accelerate their economic development. Their efforts did not succeed and bv 1981 they were unable to meet their hard currency debt service obligations.

-- The official creditors rescheduled 90 percent of the principal and interest payments due them in the last three quarters of 1981 over an 8 year period including a four year grace period. The banks rescheduled 95 percent of 1981 principal payments over the same time frame.

-- The Poles have met all the conditions of the 1981 bank rescheduling agreement: the 1981 interest payments, the 5 percent of principal that was not rescheduled but instead was deferred into 1982,* and the interest charges levied on the rescheduled amount.

-- In contrast, the Poles have not fulfilled all the conditions of the official rescheduling. The U.S. Government for example, has received only $16 million of the $42 million that was not rescheduled and due to be paid.

-- The official creditors have refused to enter into rescheduling discussions with the Poles regarding their 1982 debt service obligations until the GOP meets the three political pre-conditions agreed to by NATO allies.

-- Western banks have negotiated a 1982 rescheduling with the GOP along the lines of the 1981 agreement. They also agreed to set up a separate short-term trade facility which provides short-term funds out of half of the 1982 interest payments made by the Poles.

-- At a tour-de-table of the Paris Club last week, the official creditors indicated that were not receiving full payment on the non-rescheduled debts. They agreed to a creditors only meeting on October 25-26 to review Polish performance under the 1981 rescheduling.

-- The Kasten and Helms Amendments prohibit the USG from honoring its guarantees to banks on Polish debt unless a monthly waiver is provided to the Congress by the President, indicating that it is in the national interest not to declare Poland in default. Two such waivers were sent by Secretary Shultz to whom the authority was delegated by the President.

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* The last installment of this amount is due in November 1982.

Background

Beginning in the early 1970s, the Poles financed a large portion of their economic growth by borrowing from the West, enjoying relatively easy access to Western capital markets. As their development plans began to falter, they became less able to service their debt.

In 1972, Poland's gross hard currency debt totaled $1.6 billion. Its debt service, consisting of $200 million of principal and $74 million of interest, amounted to only 15% of its foreign exchange earnings from exports of goods and services to non-Communist countries. Poland's imports from non-Communist countries exceeded its exports to these countries by $1.3-$3.3 billion annually between 1973 and 1979 as the authorities continued to pursue their development program. By 1979, Poland's external hard currency debt stood at $21 billion and its debt service ($3.6 billion in principal and $2.2 billion in interest payments) equalled 92% of its hard currency export earnings. By mid-year 1981, Poland's hard currency debt stood at approximately $26 billion. It owed roughly $20 billion of this to 16 Western countries, $11 billion to official creditors or guaranteed by them, including $1.9 billion to the U.S. Government; and $9 billion of unguaranteed debt to private banks, including $1.3 billion to U.S. banks.

Developments in 1981

At the beginning of 1981, it was estimated that Poland would require some $11 billion in hard currency financing to cover its projected trade deficit for 1981 and to service its debt. Poland was clearly not in a position to raise such sums and on March 26, 1981, Poland notified its creditors that it would no longer be able to guarantee payment of its external debts.

The governments and private banks responded to the Poles by agreeing to enter into debt rescheduling negotiations. Separate debt rescheduling exercises were organized by the official and private creditors. Fifteen official creditor nations (later increased to 16 with the addition of Spain) concluded negotiations with the Government of Poland and a multilateral debt rescheduling agreement was signed in Paris April 27, 1981. This agreement served as an umbrella agreement for subsequent government-to-government agreements to reschedule 90% of Poland's debt service obligations to these creditors of both the principal and interest falling due during the last three-quarters of 1981. These obligations, totaling $2.4 billion, are to be repaid during a 4-year period beginning in 1985. Interest on the rescheduled debt is to be charged during the grace period, 1981-1985. The U.S.-Poland government-to-government agreement for rescheduling $380 million was signed on August 27, 1981.

Western banks, moving on a parallel track, established a consortium to negotiate a debt rescheduling agreement with the Polish Government by September. The consortium reached an ad referendum agreement with the Poles for rescheduling 95% of the principal ($2.3 billion) of their debt falling due during April-December 1981, over 8 years, including a 4-year grace period. The consortium of Western banks also set a pre-condition for signing the document, namely that Poland pay all of the 1981 interest-an estimated $700 million-which fell due in the last 9 months of 1981. The Poles were unable to fulfill this condition until May 1982.

The interest rate charged by the banks on the rescheduled debt was 1 3/4 percent above LIBOR. These interest charges are to be paid over the life of the agreement, including during the grace period. The banks also levied a 1% signature fee -- $27 million -- which they collected when the agreement was signed.

Payment of the 5 percent of principal -- about $160 million -- that was originally due in 1981 was subsequently postponed until 1982 when it was to be paid in three equal installments beginning in May.

Developments in 1982

A. Official Creditors

On December 13, 1981, the Government of Poland declared a state of martial law. In January 1982, Poland's official creditors decided not to enter into discussions to reschedule Poland's 1982 debt service obligations due them until the GOP: 1) terminated martial law; 2) released the prisoners; and 3) entered into substantative negotiations with the Church and Solidarity. They reaffirmed this agreement in August after reviewing the political gestures announced by General Jarulezski on July 22, 1982, celebrating the 35th anniversary of the installation of the communist reqime in Poland. Notwithstanding their reaffimation of the three political pre-conditions for rescheduling discussions, European Governments indicated their willingness to proceed with technical talks on Poland's debt.

At a tour-de-table of the Paris Club last week, it was duly noted that the Polish Government has not completely fulfilled its obligations under that agreement. The U.S. Government, for example, has received only $16 million of the $42 million that was not rescheduled but due in 1981. Other governments have also not fully collected the non-rescheduled 1981 debt service obligations due them. It was agreed that there would be a creditors only meeting on October 25-26 to review Polish performance under the 1981 rescheduling. (For calendar year 1982 Polish debt service obligations to the U.S. Government total an estimated $340 million.)

B. Western Banks

The Poles are current on their obligations to western banks under the terms of the 1981 rescheduling agreement. They have 1) made all the 1981 interest and signature fee payments necessary to implement the agreement, 2) paid two of the three installments on the 5 percent of principal that was postponed into 1982 when they came due (the third installment is due in November), and 3) are apparently current on the interest payments on the rescheduled debt. The western banks and the GOP have also agreed to terms on a rescheduling of Poland's 1982 private debt service obligations. The rescheduling terms are essentially the same as in the 1981 agreement: 1) 95 percent of principal -- approximately $2.2 billion -- is to be rescheduled for 7 1/2 years including a four year grace period; 2) the remaining 5 percent is to be paid in two installments in 1983. 1982 interest payments falling due between a) January and April 1982 are to be paid on October 20, 1982, b) May and August 1982 are to be paid on December 20, 1982, and c) September and December 1982 are due March 20, 1983. There is a 1 percent signature fee and the interest charge on the rescheduling is again 1 3/4 percent above LIBOR.

The banks and the Poles also arrived at a separate agreement regarding the provision of a trade facility. Western banks will make half of the 1982 interest they collect available to the Poles in the form of 6 month loans to finance exports to Poland from the banks' home country. As these loans are repaid they can be rolled over. An interest rate of 1 1/2 percent above LIBOR is charged on these new loans. This trade facility will expire in one year but can be renewed for a second and again for a third year.

The signing deadline for these two agreements has been set for October 20, 1982.

The above agreements only cover the non-guaranteed portion of Poland's debt to western banks. As for the CCC guaranteed debt, CCC has made payments, totaling $254 million, to U.S. exporters and banks through September 22, 1982. In addition, $273 million due CCC during the first eight months of the calendar year under the direct credit program has not been paid.

CCC's exposure in subsequent fiscal years is as follows (amounts in millions):

Fiscal Year	Direct Credit	Guarantee Programs
1983	$75.7	$373.7
1984		223.8
1985		9.0

C. Kasten Amendment

The Urgent Supplemental Appropriations Act (P.L. 92-216) enacted July 18, 1982, contained an amendment (Section 205) introduced by Senator Kasten, which prohibits the Commodity Credit Corporation or any other U.S. agency for the remainder of fiscal year 1982 from paying funds to cover guaranteed or insured loans to Poland unless 1) Poland is declared in default or 2) the President reports monthly to the Congress that such payments serve the national interest of the United States. The President delegated the reporting responsibility to the Secretary of State, who, after consultation with the heads of interested Executive agencies, has filed reports for July and August (August report attached). The amendment expires September 30, 1982, and will be replaced by a similar amendment sponsored by Senator Helms. Papers are in process to seek delegation of Presidential authority to the Secretary of State to report monthly to the Congress for FY '83.

Attachment
Secretary Shultz letter on Kasten Amendment

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THE SECRETARY OF STATE
WASHINGTON

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September 9, 1982

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Dear Mr. President:

This report is submitted in accordance with Section 205 of the Urgent Supplemental Appropriations Act of 1982, Public Law 97-216. Section 205 requires a monthly report be submitted to Congress explaining the manner in which the national interest of the United States has been served by payments made during the previous month to private individuals or corporations in satisfaction of assurance agreements or payment of loan guarantees entered into by any agency or corporation of the United States Government with respect to loans made and credits extended to the Polish People's Republic, in the absence of a declaration that the Polish People's Republic is in default of its debt to such individuals or corporations.

During the month of August, the Commodity Credit Corporation (CCC) made payments to the U.S. creditors on credits guaranteed by the CCC on which payments had not been received from the Polish People's Republic. The national interest has been served by making these payments in the absence of a declaration of default for the following reasons:

1. Continuing to insist that Poland pay its debts to the West in a timely manner is the best way to keep pressure on the Polish Government. Keeping the pressure on Poland has generated a net financial flow from Poland to the West. The drain on the Polish economy, together with our economic sanctions, is forcing the Jaruzelski regime to pay a heavy price for the suppression of human rights and freedom in Poland. By contrast, a declaration of default at this time would be contrary to the national interest of the United States, as it could lead to an illegal repudiation by Poland of its debt obligations, and thereby reduce the financial pressure. Since Poland becomes indebted to the U.S. Government agencies in the amount of their payments to the U.S. creditors, a declaration of default would thereby reduce the likelihood that the U.S. Government would recover these amounts from Poland.

2. Not declaring default at this time is consistent with a multilateral approach towards Poland and the Soviet Union

The Honorable
George Bush,
President of the Senate.

adopted by the United States and its NATO allies. Such a coordinated approach strengthens the effect of our policy toward Poland, promotes Allied unity and best serves the national interests of each Western country. At present, the consensus among our NATO allies is that our mutual interests are best served by not declaring a default at this time.

Sincerely yours,

George P. Shultz

Options Paper: Private Sector Initiative for Poland

Issue

SIG guidance is required on a staff proposal that a Presidential Commission be established to spearhead a private sector assistance program for Poland -- with primary emphasis on technical and economic assistance for agriculture.

Funding for the initiative would be derived from two sources:

(1) Private sector donations. (The Commission would designate an organization to conduct a fund raising drive and to receive donations.)

(2) The U.S. Government's holdings of zloty funds for in-country use.

In addition, after the Commission had devised a private sector assistance program, and determined how much assistance was needed, if any, the U.S. Government would consider rendering government funds.

The President will meet with Polish Cardinal Glemp on October 15, 1982, at which time we expect the question of humanitarian aid and a U.S. response to the Church's $2.02 billion proposal for aid to the Polish private sector will be discussed.

Pros and Cons

Those who are in favor of the proposal argue that:

-- it supports the Administration's policy of providing humanitarian assistance to the Polish people;

-- it would strengthen, over the long-run, Poland's private agricultural sector and help to moderate the Polish Government's domestic policy;

-- it would send a signal to the Polish Government without compromising the integrity of our sanctions;

-- it would engender a positive image of American flexibility, which would put the Polish Government on the defensive and bolster our position vis-a-vis our allies; and

-- it would be welcomed by the Polish American Community and the Church as consistent with the Polish Church's own recommendation for a five-year, $2.02 billion recovery plan.

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Review for Declassification on 9/24/90

Those who oppose the proposal argue that:

-- the proposal is not well-defined with a clear set of objectives and lacks a precise plan to achieve those objectives;

-- Poland's immediate humanitarian needs cannot be satisfied by a broad long-term economic plan designed to restructure its private agriculture sector;

-- using zlotys does not provide resources;

-- resources therefore must come from the private sector for which there is little certainty, or from the Government, in which case the plan would no longer be private;

-- moreover, the Polish authorities would see this as Western propaganda and would not allow the scheme to succeed;

-- even if some resources did reach Polish farmers, benefits would also accrue to the State agricultural sector, which is supplied in part by the production from the private agricultural sector; and

-- our allies have not been consulted and there are no indications of what their reaction would be in the wake of our sanctions against their firms.

Discussion

There are several points which need to be taken into account in evaluating this proposal:

(a) Clarification of objectives: We need to determine whether the scheme is designed primarily as humanitarian or economic development assistance. We have already provided $41 million in PL-480 Title II assistance in FY 82 (for CARE and Catholic Relief), and $40 million for FY 83; we have also earmarked $5 million for Project Hope in FY 83 for medical assistance to Poland. There are no plans for providing Government funds for this proposal and, indeed, should we do so the scheme would lose its private character.

(b) Funding: This is uncertain and poses several dilemmas:

--- We have approximately $29 million worth of zlotys which could be used to finance expenses denominated in zlotys. The use of these zlotys requires agreement by the Government of Poland, which we have yet to obtain.

-- The authority to use these funds for this purpose expires at the end of this fiscal year. If Congress does not take action to extend this authority in the continuing resolution now under consideration, it will have to do so in a permanent appropriation (probably before December 15, 1982).

-- Substantial sums of money will be required if the effort to restructure private agriculture is to succeed. There is no assurance that the private sector can raise such amounts.

-- If private sector funding were inadequate, then the Government would have to provide funding to insure its success. There are no budget provisions or plans to do so but if there were Government funding, the program could truly not be deemed private.

(c) Timing: It has been proposed that we announce and explore this proposal in conjunction with the Glemp visit on October 13-15, 1982. As an alternative, we could also consider developing it for possible use in response to positive developments in Poland if all other allies would join with us.

(d) Political Impact (See State Paper Attached)

-- Allied reactions would depend on:

- whether the initiative were perceived clearly as humanitarian assistance and not indirect balance of payments support for the Polish Government that would undercut Western sanctions; and

- how the idea was presented. (An initiative to help the Polish private sector specifically could be greeted with skepticism if it seemed to be an effort to undermine the system in Poland.)

-- Polish reaction:

- Embassy Warsaw believes the Polish people would react favorably.

- The Government's attitude is not clear; they would seek to maximize control over the distribution of any imported resources and would probably not agree to the use of surplus zlotys.

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-- Soviet reaction: They would probably oppose it since they have been attacking private agriculture and the Church in Poland (unless the funds were so substantial as to alleviate the pressure for them to assist the Poles).

-- U.S. reaction: The Polish American community would react positively so long as there were assurances that the assistance was channeled through the Church, that it reached its intended recipients, and we were not assisting the Polish Government.

-- Congressional: Strong support by Polish-American Congressman; opposition by those who would read it as undermining sanctions.

Options:

There are several courses of action which the SIG should consider:

1. Remand the proposal for further staffing.

Those who favor this approach believe it is the only logical course of action, given the large number of uncertainties discussed above. Those who oppose remanding argue that we will have lost a timely opportunity for political gains with the Polish Church and Polish community.

2. Reject the proposal altogether

See "con" arguments above.

3. Pursue the initiative preferably with participation by our allies but unilaterally if necessary. The announcement would be linked to the Glemp visit.

See "pro" arguments above.

4. Proceed with the proposal but limit any U.S. Government funding to zloty-denominated administrative expenses (a variant of option #3).

With no funding certainty, this would cast the proposal primarily as political encouragement for a strictly private, undertaking with no assurances or responsibility for success or failure.

5. Request Secretary Shultz to explore it with our allies at the UN General Assembly,

   a) as a U.S. initiative to gain allied support, or

   b) only to sound out our allies on the concept.

Attachments:

Background paper on Private Sector Initiative
Draft Executive Order
State paper on Reaction to Public Sector Initiative
USDA Table on Food Aid to Poland

I. Background: The United States Government has proposed an initiative whereby the U.S. private sector would render assistance to the Polish private sector -- with primary emphasis on agriculture. The initiative was conceived prior to the Polish Church's recommendation for a five-year, $2.02 billion "Poland Recovery Plan" to aid the private sector, but coincides with the Church's proposals. This initiative is perceived as a humanitarian "people-to-people" effort, consistent with the Administration's policy toward Poland. Its purposes include: a) strengthening the Polish private sector which has suffered from years of inconsistent and arbitrary government interference and lack of suitable investment, (b) sending a signal of moderation to the Polish government without compromising the integrity of our sanctions, (c) promoting in the long term a more moderate domestic Polish policy as a result of strengthened free market forces.

-- As this is a private sector initiative, the official involvement of the U.S. Government will be kept to a minimum.

-- This initiative will not nullify but rather support the Allied declaration of January 11, 1982, and the three criteria it endorsed.

-- No detailed blueprint of the initiative can or should be prepared at this time for the private sector organizations will be responsible for its preparation and implementation.

-- The funding sources are subject to possible change per relevant discussions with Polish authorities. The U.S. is prepared to manifest some flexibility; however, the Polish government must be prepared to accept the general framework of the initiative.

II. Establishment of Commission: The United States Government is establishing a Presidential Commission to spearhead the private sector assistance program for Poland. The Commission shall be composed of no more than 12 members to be appointed by the President. The 12 members will be drawn from the Polish-American community, labor, academia, the Church, farm associations, agricultural industries. One Commission member will serve as a liaison to the European Community. Functions of the Commission shall include a) assessing the current condition and needs of the Polish private agricultural sector, b) devising and implementing an economic and technical assistance program to bolster the Polish private sector -- with emphasis on agriculture, c) generating public support for the private sector assistance initiative, d) coordinating the U.S. program with similar initiatives undertaken by our allies and/or developing a program jointly with them, and e) providing a quarterly progress report to the President. The Commission will conduct regular meetings and utilize such other procedures as it may deem necessary for the effective performance of its functions.

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III. Funding: Funding for the initiative will be derived from two sources:

Private: The American private sector is expected to make donations in support of this effort. The Commission will designate an organization to conduct a fund raising drive and to receive donations.

Public: The United States Department of Agriculture will provide zloty funds (up to $70 million in CCC-owned zlotys) for in-country use. After the Commission has devised a private sector assistance program, and has determined how much assistance is needed, if any, the U.S. Government will evaluate the program and will consider rendering additional government funds (perhaps part of the Economic Support Fund or a supplemental) commensurate with the needs of the program and as may be necessary for its successful and effective implementation.

IV. Presidential Statement: The President will announce the establishment of the Commission on October 13.

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TO POLAND

By the authority vested in me as President by the Constitution and statutes of the United States of America, and in order to assist and improve the well-being of the Polish people who have endured many hardships, it is hereby ordered as follows:

Section 1. Establishment. (a) There is established the Presidential Commission on Private Sector Assistance to Poland, which shall be composed of not more than twelve members from the private sector appointed by the President.

(b) The President shall designate a Chairman and Vice Chairman from among the members of the Commission.

Section 2. Functions. (a) The Commission shall assess the current condition and needs of the Polish private agricultural sector; and, devise and implement an economic and technical private sector assistance program to bolster the Polish private agricultural sector.

(b) This private sector assistance program shall include plans for:

(1) generating public support for this private sector assistance program;

(2) coordinating the United States private sector program with similar programs undertaken by our European allies; and

(3) submitting a quarterly progress report to the President.

Section 3. Administrative Provisions. (a) The Secretary of Agriculture shall, to the extend permitted by law and subject to the availability of funds, provide the Commission with such administrative services, funds, facilities, staff and other support as may be necessary for the effective performance of its functions.

(b) Members of the Commission shall serve without compensation. While engaged in the work of the Commission, members may receive travel expenses, including per diem in lieu of subsistence, as authorized by law (5 U.S.C. 5701-5707).

Section 4. General Provisions. (a) The Commission is authorized to conduct meetings and utilize such other procedures as it may deem necessary, and under such conditions it deems appropriate, for the effective performance of its functions.

(b) The Commission shall terminate one year from the date of this Order.

THE WHITE HOUSE

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USE OF CERTAIN POLISH CURRENCIES

Section . Delegations of Authority. (a) The functions vested in the President by section 709 of the International Security and Development Act of 1981 (Public Law 97-113) with regard to programs in agriculture, including activities to assist the private agricultural sector in Poland, are delegated to the Secretary of Agriculture.

(b) In carrying out these functions the Secretary of Agriculture shall coordinate his activities with those of the Presidential Commission on Private Sector Assistance to Poland, make available Polish currencies received by the United States from the April 1981 and October 1981 sale of United States Government-held dairy products to Poland in such amounts as designated by the President in advance to United States private sector groups in support of activities of common benefit to the people of the United States and Poland which assist in meeting the objectives of the private sector assistance program.

Probable Public Reaction to Private Sector Initiative to Assist Polish Agriculture

Allied Reaction

West European governments and public continue to support strongly the provision of humanitarian assistance to the people of Poland. In this regard, the September 16 meeting of the European Parliament and resolution on Poland is instructive. The resolution inter alia calls for stepped up food and humanitarian aid to the Polish people but demands that "no new offers of credit and aid in any form whatsoever be made" beyond humanitarian assistance. In short, the resolution supports Western sanctions directed at the Polish government. Thus, as long as the U.S. private sector initiative were perceived clearly as humanitarian assistance and not indirect balance of payments support for the government that would undercut Western sanctions, the European public is likely to be supportive. For the initiative to be perceived as such, however, the crucial problems of the extent of USG participation and the amount of private versus public financing must be adequately addressed:

-- An assistance program of modest size earmarked for the private Polish agricultural sector would be least likely to be misinterpreted, or to send conflicting signals concerning U.S. sanctions policy.

-- USG participation, especially financial, would need to be kept small to preserve the "private" character of the U.S. initiative but not so small as to permit lack of funds to endanger its viability. Conversely, private sector support would need to be large enough to make the exercise credible.

-- The Allies should be consulted in advance of the announcement to avoid confusion and misinterpretation.

-- GOP participation in administering the initiative, while unavoidable, would need to be kept to a minimum. The Church and volags should have the principal responsibility in channeling U.S. private assistance to Polish private farmers.

The West European reaction to the US initiative would also depend on how the idea was presented. An initiative by the American private sector to help the Polish people would gain strong approval. The Europeans, especially the Germans, have stressed private relief efforts to Poland and would be pleased to find an American initiative which supported their efforts. However, an initiative to help the Polish private sector specifically could be greeted with skepticism if it seemed to be an effort to undermine the system in Poland. The initiative would require careful explanation to ensure that it is not perceived as contradictory to our sanctions policy.

Polish Reaction

Embassy Warsaw believes that the Polish people are prepared to react favorably to any U.S. initiative, especially one involving aid to private agriculture, an eventual increase in the food supply, and expanded people-to-people contacts. The Polish population would welcome this demonstration of continuing American interest in their personal well-being. Solidarity's attitude is uncertain, but the larger German bishops' scheme was reportedly explained to Lech Walesa and received his approval, an indication that the more modest U.S. proposal would also be welcomed. Moreover, the US initiative would be well received by the Polish Church.

By contrast, the Polish government's attitude is uncertain. Embassy Warsaw believes that a Presidential announcement which reaffirmed USG sanctions policy while announcing an initiative directed at private farmers might well lead the regime to "reject the initiative out of hand". In any event, the GOP would be extremely cautious in considering a U.S. proposal and seek to maximize control over the distribution of any imported resources. The GOP is highly unlikely to agree to the use of U.S.-owned surplus zloties which represent no new resources. Moreover, the GOP is likely to judge the proposal in terms of "whats in it for us "with respect to resource flows from the West.

Soviet Reaction

Moscow has been attacking both private agriculture and the role of the Church in Poland. Consequently the Soviet reaction will probably be negative. The motivation behind a "private" sector initiative announced by the President and containing possible U.S. Government financing would be questioned. The USG would probably be accused of seeking to build up the Church and undermine the Polish regime and system which is precisely our intent.

U.S. Reaction

Reaction to the proposed initiative from the Polish-American community would be positive so long as they were assured that the assistance would be channeled through, and monitored by, the Polish Church and that it reached its intended recipients. The media reaction is likely to be skeptical with a "wait and see" attitude regardiing the Commision's report. Media skepticism will be heightened by the lack of commitment, to any public feeling. General U.S. public reaction is likely to be supportive, but muted.

Congressional Reaction

The Congressional reaction is likely to vary dramatically from support by Polish-American Congressman who have backed U.S. aid to private agriculture in Poland (i.e. the Obey delegation to Poland), to opposition from many members who will see the proposal as undermining sanctions.

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PM:JAzrael

FOOD AID -- POLAND

Sales and Donations

	FY 1982		FY 1983	
	MTs	$000	MTs	$000
Sales				
CCC-Sale to CARE				
Butter	10,000	15,750	-	-
Cheese	8,000	8,200	-	-
NFDM	10,000	7,700	-	-
Total	28,000	31,650	-	-
CCC Sale to CRS				
Butter	600	66	-	-
Cheese	400	44	-	-
NFDM	8,000	880	-	-
Total	9,000	990	-	-
Title II Donations	(Estimated)	Programed Levels	(Proposed)	
CARE				
Corn Soy Blend	6,900	2,355	-	-
Corn Soy Milk	8,913	3,169	4,000	1,140
Nonfat Dry Milk	1,400	202	9,052	998
Rice	2,000	594	11,800	3,680
S.F. Rolled Oats	1,500	587	5,974	2,298
Soybean Oil	4,900	3,739	8,052	6,464
Wheat Flour	2,400	578	6,162	1,522
Wheat Soy Blend	8,949	3,297	4,133	1,190
Wheat Prot. Conc.	-	-	4,344	2,976
Peas	-	-	4,014	1,405
Butter	-	-	3,600	397
Subtotal	36,962	14,521	61,131	22,070
Est. O.T.		3,200		3,188
Total		17,721		25,258
CRS				
Nonfat Dry Milk	3,000	433	5,694	626
Butter	3,000	331	5,694	626
Cheese	3,000	331	5,694	626
Wheat Flour	36,608	8,821	20,962	5,124
Rice	5,285	1,568	2,962	933
Soybean Oil	6,460	4,980	3,630	2,940
Subtotal	57,353	16,464	44,636	10,875
Est. O.T.		9,500		7,778
Total		25,964		18,653
Grand Totals	94,315	43,685	105,767	43,911

USDA/FAS/PAD 9-24-82

ECONOMIC SANCTIONS IN FORCE AGAINST POLAND

U.S. SANCTIONS AGAINST POLAND:

1. Suspended all U.S. official and guaranteed credits for Poland.

2. Suspended Export-Import Bank's line of export credit insurance for Poland.

3. Agreed with other creditor governments not to negotiate rescheduling of official debt falling due in 1982.

4. Suspended LOT civil aviation privileges in the U.S.

5. Suspended Polish fishing privileges in U.S. waters.

6. Stopped issuing export licenses for high-technology items consigned to Poland.

ALLIED SANCTIONS AGAINST POLAND:

-- Suspended official credits to Poland for goods other than food.

-- Agreed to suspend indefinitely negotiations with Poland on rescheduling 1982 official debt.

-- Agreed to undertake not to undermine U.S. sanctions, and to maintain close consultations with us to that end.

All the above measures remain in full effect, including those agreed to by the Allies. Some Allies are, however, uneasy at the prospect of continuing indefinitely the ban on rescheduling. The sanctions are having a substantial effect on the weak Polish economy: Poland's imports from the West in the first half of 1982 were 42% below the level for the same period last year, as a result of our credit sanctions. The sanctions have been a major factor in the continuing decline in Polish industrial output and the sharp drop in Polish living standards.

Drafted:EUR/EEY:DRGrabenstetter
Cleared:EUR/EEY:JRDavis
EUR:RBurt
EB/IFD:EConstable

AGENDA ITEM 4

U.S.-INDIAN ECONOMIC RELATIONS

In order to safeguard important political and security interests at stake in U.S. relations with India, the President has directed the SIG-IEP to explore and present for NSC consideration ways in which the United States might support India in its development efforts.

At an Interagency Group (IG) meeting on September 1 there was a consensus that (1) in the near-term and in view of India's own priorities, we should focus on multilateral assistance and how the United States should fulfill its commitment to higher levels of MDB hard window borrowing; and (2) for the longer-term, we should take steps now to foster an economic relationship based more on expanding commercial ties and less on aid. The purpose of the SIG meeting is to consider steps we might take to fashion a more positive economic relationship with India within the constraints of US policies and regulations. If there is agreement, these measures could be transmitted to the NSC by September 30.

1. Indian Borrowing from the World Bank. The United States should support growth in total Indian borrowing from the MDBs in order to enable India to deal better with its development problems and to continue the liberalization of its economy. In addition, given IDA/IBRD funding constraints, the more active participation of a major new borrower (i.e. China), and an increased Bank focus on the African region, growth in India's FY 83-86 borrowings vis-a-vis FY 79-82 borrowing will likely increase only in nominal terms. The U.S. position on Indian borrowing from the World Bank, however, must clearly reflect U.S. policies of reducing India's share of IDA credits and moving India toward harder IBRD loans. The United States will, therefore, work toward greater Indian access to IBRD lending, within the limits of future replenishments and Congressional appropriations, in order to offset reductions of IDA credits to India.

2. Indian Request to Borrow from the Asian Development Bank (ADB). Before the Gandhi visit, Treasury and State agreed that the United States would see if it was possible to prevent India's borrowing from the ADB through high level contacts with Japan and possibly others. If preventing Indian borrowing seemed unrealistic, it was agreed to seek to limit any such borrowing to a modest amount. Since then the Japanese have indicated opposition to Indian borrowing. If they hold firmly to this position, the chances seem good of preventing lending to India, without signicantly damaging bilateral relations via an overt U.S. campaign. The key to our strategy should be to work closely with the Japanese and ADB management on this issue. If there were to be ADB lending to India, it could generate Congressional opposition to the ADB and possibly place all pending MDB legislation at risk; e.g., Indian access to the ADB could have negative spillover effects on ADF, ADB, and World Bank legislation.

3. Indian Borrowing from the IMF. On the assumption of a continuation in India's good performance to date under the IMF program, India's continued need for large balance of payments assistance, and the appropriateness of the third-year targets, the United States hopes to support the third year of the program. During the first year of India's 3-year (1981-83), $5.8 billion Extended Fund Facility, the Indians implemented the program well. Although the United States abstained on the first year of the program because of doubts about the need for a loan of this size and India's commitment to adjustment, it supported the second year because the Indians had met all performance criteria and were making significant progress on achieving structural adjustments, long advocated by the World Bank as well as in the IMF program.

4. Expanding Commercial Ties. We are in the process of promoting greater trade and technical collaboration with India, e.g, through the planned OPIC and trade missions next year. We regularly discuss the range of trade issues with the Indians. The Indians do not seem to be interested in some commercial - related initiatives, such as the North/South trade discussions in the GATT ministerial or a bilateral investment treaty. The Indians do want greater access to the U.S. market for their exports, but there are severe limitations on the ability of the United States to be more open to Indian products. Nevertheless, we could propose a meeting with the Indians at the sub-cabinet level in order to explore trade and investment objectives to determine the extent of mutual interest and to demonstrate U.S. goodwill in seeking closer, mutually beneficial ties.

5. Congressional Views on India. India's current government is giving greater scope to the Indian private sector, foreign investors, and market mechanisms in the country's economic development. Recent changes in India's economic and foreign policy may not yet have been recognized in Congress. Its strategic interest to the United States may not be fully appreciated. It has also generally taken fairly pragmatic positions in international fora. If we are to effect any improvement in U.S.-Indian economic relations, the Administration should launch a quiet educational campaign on the Hill to inform legislators about the recent evolution in India's economic performance and policies.

Attachments

The attached paper from State provides background and a rationale for the President's directive on India and proposes an overall economic strategy. There is also a paper which might be used for contacts with the Congress. Also attached are background papers on the Indian business climate, climate for economic development, and U.S.-India trade relations prepared by the participants in the IG meeting of September 1 on India.

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An Economic Strategy for Managing Our Relations with India

India's size, industrial muscle, military capabilities and political stability make it an intrinsically important regional power. These factors give India central importance in any consideration of U.S. security interests in the South Asia region and adjacent areas such as Southwest Asia and the Persian Gulf. India is capable of taking actions which affect those interests, particularly in Pakistan and Afghanistan. As the President has directed, it is essential that we be able to relate positively to India in its development efforts in order to safeguard important U.S. political and security interests at stake in our relations with India.

U.S. Objectives

Our approach to this task has had two objectives. In the short term we want to avoid provoking Indian actions that could be harmful to our security interests in the region of South and Southwest Asia. Our strategy there is in significant part premised on a militarily strong Pakistan capable of resisting Soviet pressure from Afghanistan. If the Indians become convinced that there is little advantage to them in a constructive relationship with the U.S., and considerable danger as a result of our r lationship with Pakistan, their reaction could grow from critical rhetoric to more concrete actions, possibly in concert with the Soviet Union.

Our objective over the longer term should be to build a relationship of mutual benefit with India which reflects its intrinsic importance in South Asia and beyond. In doing so, we can serve a variety of important U.S. foreign policy interests. First is a loosening of the close relations India has had with the Soviet Union for the last two decades, including a more helpful stance toward efforts to bring about Soviet withdrawal from Afghanistan. Second is the promotion of regional detente, particularly between India and Pakistan and India and China, leading to greater stability in the area, a longtime U.S. goal. To the extent this can be achieved, it will lessen India's felt need for a Soviet counterbalance to the threats it presently perceives from Pakistan and China, and the sensitivity to Soviet interests which this encourages.

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Indo-Pakistani and Sino-Indian reconciliation also will improve the prospects for nuclear detente in South Asia. Further, better Indo-U.S. bilateral relations can facilitate our wider non-proliferation objectives in that they will provide a basis for a constructive dialogue with India on nuclear issues. Finally, while India and the U.S. are apt to continue to find themselves at odds on certain specific issues for the indefinite future, improved bilateral relations may, over time, have a positive spillover effect in the form of greater Indian sensitivity toward U.S. interests in various international fora.

Developing A Strategy

Foremost among our assets is India's own desire for better balance in its relationships with the two superpowers. This provides us with an opportunity. But to capitalize fully on it we will have to be able to demonstrate to India that there are tangible benefits to be derived from improved relations with us. It is clear from Mrs. Gandhi's comments during her visit that she closely associates improved relations with the U. S. with greater U.S. sympathy for India's economic needs as India sees them. Both the will and the ability of the Indian Government to take U.S. interests into greater consideration in its policies will be significantly influenced by our responsiveness in the economic area. In the short term that means, above all else, multilateral assistance.

Mrs. Gandhi recognizes that the Indian economy is today far stronger than it was 20 years ago and that it promises to be stronger yet in the future. Nonetheless, she and her chief advisors see a transitional period ahead during which India will continue to require assistance on concessional and partly subsidized terms. We can differ with India on the specifics (such as the length of the transitional period, the mix of funding, etc.). But we cannot be perceived by the Indians as indifferent or even hostile to their economic interests if we are to take full advantage of the opening provided by the successful Gandhi visit which itself demonstrated the enhanced possibility of India taking U.S. concerns into greater account.

Elements of the Strategy

Just as we have short and long term objectives with regard to India, we need a strategy with short term and long term elements for achieving our objectives. Economic and commercial cooperation offers the most promising and effective means to accomplish our objectives throughout this decade. In pursuing our strategy, however, we need to recognize the inherent limitations and constraints on both sides. Moreover, we want our approach toward India to reflect clearly the fundamental tenets of U.S. policy regarding Third World development. This means, for example, moving the Indians gradually away from concessional credits toward hard loans and private financial markets, and encouraging them to allow a greater role for the private sector in their development.

In the short term, both from the point of view of Indian priorities and what we ourselves can reasonably do to protect our interests we should focus on multilateral assistance. The State-Treasury agreement reached just prior to the Gandhi visit provides a framework for this. Growth in total Indian borrowing from the MDBs will enable India to deal better with its development problems and to continue its more liberalized economic approach. Indian success in this regard will enhance stability in India itself and the region at large. At the same time, the risk of India taking actions inimical to our interests because of our policy toward IDA will be lowered.

Taking a reduction of India's share of IDA-7 as a given, there are three means of fulfilling the State-Treasury agreement:

1. More IBRD lending (India's share would have to be increased sharply unless we reconsider our preference for not accelerating the GCI);

2. An annual U.S. contribution greater than $750 million to IDA-7 (thus offsetting somewhat the net effect of a reduced percentage share of IDA for India); and as a possible supplement

3. Some borrowing by India from the ADB (Japanese opposition to Indian borrowing would eliminate this option).

None of these alternatives can be implemented without difficult policy decisions and some combination of them may prove desirable. State and Treasury will have to work closely together in weighing the political and economic advantages and liabilities of various scenarios.

In the second half of the 1980s, as the considerable investment in India's petroleum sector already underway begins to pay off in reduced (in real terms) oil import bills, we can move increasingly to a relationship with India based less on aid and more on trade and other private sector commercial activities. The Indian economy is becoming more integrated into the international economic system as evidenced by its growing requirements for western technology, finance, and markets and by its improving business environment. We want to encourage these directions so as to link India's basic economic interests more closely to the West, thus better protecting U.S. security objectives in the region and promoting a more positive Indian posture, and influence on other developing countries, in multilateral fora. The key elements of the U.S. approach should be to:

-- Promote commercial ties in order to increase Indian reliance on the U.S., strengthen the role of the (generally pro-Western) Indian private sector, and build business constituencies with a stake in each other's countries. Despite the shortage of competitive export credit financing, there is good scope for U.S. business in India's rapidly expanding energy and electronics sectors. We want to stimulate greater willingness by U.S. firms to consider collaborations in India through such means as OPIC and trade missions, joint projects in third countries, a bilateral tax treaty and encouragement of a better business climate in India.

-- Consider ways to allow India to increase its exports to the U.S. in order to strengthen India's stake in the bilateral relationship and provide an enhanced alternative to trading with the USSR which offers flexible and advantageous terms. Especially, in view of a growing debt burden, stagnating aid, and a large balance of trade deficit with the U.S., the Indians want to expand their exports to the U.S. market. They seek more advantages under GSP and easier access for their products, both those currently being exported to the U.S. and the more sophisticated ones they hope to introduce. Given the constraints of policy and regulation on us, it will not be easy to devise meaningful concessions, as is evident in the current negotiations of the bilateral textile agreement and the prolonged dispute over countervailing duties. It will be critical, however, to do so if the U.S. is to relate positively to India in its development efforts in the longer term.

-- Respond to Indian desires for closer bilateral consultations on international economic issues in order to foster Indian cooperation, moderation, and, when helpful to us, leadership in Third World fora. India already understands that its interests are served by practical cooperation with the IFIs and by working with the Western market system rather than by philosophical posturing in international fora. We should seek to engage the Indian economy and policymakers in ways which reinforce this approach. Joint efforts in tackling such problems as foodgrain insufficiency in other LDCs would help symbolize Indo-U.S. mutuality of interest.

-- Obtain assurances from India that controlled U.S. exports of high technology will not be diverted to the USSR nor to nuclear proliferation. DOD, in particular, has been concerned about the extent of Soviet access to U.S. high technology provided to India, and regularly resists the granting of export licenses. We need to design a licensing approach to India that both satisfies our security concerns and convinces India of our reliability as a supplier of advanced computers and other sophisticated technology. These and other arrangements would tie India's modern economy closer to us over the long term and tend to add distance in its relations with the USSR.

Negative Legislative Views on U.S.-Indian Economic Relations

The Congressional attitude towards India is a major constraint on expanding MDB lending to India or granting it any non-reciprocal trade concessions. Misconceptions about India on the Hill may partly account for this attitude. An Administration effort to correct the state of misinformation on India might help defuse Congressional opposition to Administration attempts to "relate positively to India in its development efforts," as the President has directed. Recent Indian economic successes and improvements in policy, as well as background on Congressional views, are summarized below.

India -- Improved Climate for Economic Development

Prime Minister Gandhi's present government is giving greater scope to the Indian private sector, foreign investors, and market mechanisms in the nation's economic development strategy. Further liberalization of the business environment together with continuation of the responsible macroeconomic and pricing policies implemented during the first year of India's 3-year IMF program would make India a more open and dynamic economy and one with which the United States could expect greatly increased commercial ties. Some recent developments encouraging for expanded U.S.-Indian economic relations are summarized below:

1. Three-Year International Monetary Fund Program

In November 1981, the IMF approved a three-year Extended Fund Facility (EFF) for India. This loan, in the amount of SDR 5 billion ($5.8 bilion), represents the largest loan that any IMF member country ever received.

During the first year, the Indians implemented the program well and important steps toward structural adjustment, long advocated by the World Bank as well as the IMF, were taken. Price controls on iron and steel were lifted. Significant progress was made toward reducing government control of the cement market. Imports were liberalized. As percentage of GDP, the government managed to reduce expenditures and raise revenues. Monetary growth declined. Real interest rates available to savers turned positive, reflecting both the decline in inflation and higher nominal rates.

In July 1982, the IMF approved the second year of the EFF Arrangement. Although the United States abstained on the first year of the program because of doubts about the need for a loan of this size and India's commitment to adjustment, it supported the second year because the Indians had met all performance criteria and were making significant progress towards achieving the necessary structural adjustments. On the basis of the good performance to date and a continued need for large balance of payments assistance, the United States would expect to support the third year of the program.

2. Policy Toward Foreign Investment. While the government retains a highly selective stance toward foreign investment, it has begun to promote foreign "collaborations" (Indian parlance for direct investments or licensing agreements) to manufacture export-oriented products or to provide technology not available locally. The climate has evolved considerably from the 1970s when "Indianization" was on a marked rise -- and Coca-Cola and IBM closed their Indian operations as a result. Approvals of foreign collaborations have risen dramatically in recent years, and the United States has led all other countries in the number of ventures. Despite a number of improvements, however, multinational corporations generally continue to be wary of India's insistence on minority equity ownership for foreign investors and a significant export commitment. U.S. companies view India's efforts with cautious optimism and feel that, although India has taken some measures to make foreign investment more attractive, more could be done.

3. Trade Policy. On April 5, 1982, the Indian Government announced a new import/export policy which: 1) liberalized the import of raw materials, components and machinery to strengthen India's domestic production base and to further stimulate exports; 2) linked imports to export promotion for the first time; 3) simplified or removed import procedures, encouraging manufacturers/exporters to expand output and make their products more competitive in international markets. It contained virtually no additional restrictions and removed numerous procedural constraints across the board. It signalled a marked acceleration of the trend initiated with the 1978-79 import policy, which was tentative and heavily qualified. India has also aided U.S. objectives in North/South discussions on trade in UNCTAD and in the GATT by taking positions considerably less strident than many of its G-77 cohorts.

The tenor of U.S.-India trade relations will be affected in considerable measure by India's ultimate policy stance with respect to the U.S. initiatives for the GATT Ministerial. The United States has taken, and continues to take, gradual steps to improve our trade relationship with India, particularly in view of India's import liberalization moves. It should be noted, however, that even our limited steps in this direction are made more difficult by India's own policy positions (e.g., continued import restrictions on certain U.S. products and disagreements about the administration of our countervailing duty law) and by the Congressional and domestic criticism these generate.

Background

There is considerable opposition in the Congress, particularly among conservatives, to the past World Bank practice of allocating 40 percent of IDA resources to India. Increased IBRD and/or ADB lending to India could also generate similar criticism, even among non-conservative supporters of the institutions.

Critics of past MDB lending levels to India have cited both a political and an economic rationale for their position. On the political side, India's often well publicized views on such issues as Vietnam, Pakistan, and North/South have fostered a widespread perception that India's "neutral" foreign policy is both "pro-Soviet" as well as detrimental to U.S. interests.

In the economic area, India is often perceived as one of the classic cases where a combination of inward looking statist and socialist policies have wasted or significantly diluted the impact of large-scale foreign assistance inflows. Policies which have discouraged foreign investment and other private flows -- reinforced by India's tendency to view North/South cooperation primarily in terms of "aid" -- have also left India without the private sector interests on which other major LDCs (e.g. Mexico and Brazil) can rely to influence Congressional opinion. The fact that India is a nuclear power which has not signed the Nuclear Non-Proliferation Treaty and the widely shared impression that India maintains high defense expenditures (fostered perhaps by its well publicized purchases of foreign military equipment) have further diminished Congressional sympathy for India's development problems. (In fact, however, as percent of GDP, India's defense expenditures are less than the LDC mean, i.e. 3.08 compared to 3.95 for the LDC average).

On the other hand, there has also been broad Congressional support for the Administration's position that concessional IDA resources should be better concentrated on those low-income LDCs which, unlike India, do not have either the access to, or the ability to sustain, both official and commercial borrowings on harder terms.

In addition, budget conscious Congressmen have been wary of India's large absorptive capacity, a concern accentuated by the recent emergence of China as another potentially large claimant on MDB resources. With regard to Indian access to ADB resources, there is a strong Congressional feeling that Indian borrowing would be highly detrimental to the ADB's other, generally small and medium size, borrowers and fundamentally alter the nature and character of the institution. (The fact that the ASEAN countries and Korea currently receive 90 percent of the ADB's capital resources has been a major selling point for ADB legislation on the Hill.)

In sum, given current Congressional views, expanding Indian access to MDB resources could generate Congressional opposition sufficiently strong to place all pending MDB legislation at risk, e.g. Indian access to the ADB could have a negative spillover effect on IDA and GCI legislation.

Many members of Congress, and in particular those on the House and Senate trade subcommittees, view India as a difficult trading partner that pushes for increased access to the U.S. market without demonstrating any willingness to open up its own market in return. Many in Congress strongly opposed as too weak the commitment on subsidies which Ambassador Brock signed with the Government of India in 1981. Further, some believe India should be treated as a more advanced developing country and should graduate to some degree from the preferential trade status it now enjoys. Thus, Congress is unlikely to look favorably upon Administration proposals for increased non-reciprocal trade concessions for India.

CHANGING INDIAN BUSINESS CLIMATE

Prime Minister Gandhi's present government has come to recognize that the Indian private sector and foreign firms can make important contributions to India's economic development. If current policies are maintained and expanded, India could become a more open and dynamic economy. The United States has tried to encourage this liberalization in bilateral meetings with Indian government officials. We have also tried to foster greater awareness in both countries' private sectors of the new opportunities for increased trade and investment ties.

Industrial Policy. Since independence, India's industrial policy has emphasized import substitution, heavy industry and state capitalism. The record of India's nationalized industries, which hold 3/4s of the country's industrial assets and contribute only 1/3 of its industrial output, has resulted in a situation where industrial jobs have not kept pace with growth of the labor force. Former Prime Minister Desai began and Prime Minister Gandhi has continued to try to reduce obstacles to business growth. Prime Minister Gandhi's relations with large private industrial firms have been good. Her present inclinations suggest that the private sector may enjoy a freer hand over the next few years.

Last year, India introduced a series of measures to promote industrial production including provision of institutional finance for modernization to all industries and simplification of industrial licensing procedures. Units producing solely for export are now exempt from controls on expansion, import duties, local excise taxes and limits on foreign ownership. Previously, only companies setting up in two specially designated export zones (one in Bombay, the other in Kandla) had been given this status. Now the whole country is, in effect, an export zone.

Trade Policy. On April 5, 1982, the Indian Government announced a new import/export policy which:

- Liberalizes the import of raw materials, components and machinery to strengthen India's domestic production base and to further stimulate exports.
- Links imports to export promotion for the first time.
- Simplifies or removes import procedures, encouraging manufacturers/exporters to expand output and make their products more competitive in international markets.

It contains virtually no additional restrictions and removes numerous procedural constraints across the board, representing a signficant disengagement of the import regulatory mechanism. It signals a marked acceleration of the trend initiated with the

1978-79 import policy, which was tentative and heavily qualified. The policy entails a considerable risk, since it removes many of the qualifications implicit in the 1978-79 policy, reduces significant procedural impediments to imports, and does so at a time when India's foreign exchange reserves are declining. India faces a near record level trade gap. Indian export growth has been slow due to domestic supply constraints, the strong pull of the large domestic market and an increasingly unfavorable international trading environment.

Foreign Investment Policy. While the government retains a highly selective stance toward foreign investment, it has begun to promote foreign "collaborations" (Indian parlance for direct investments or licensing agreements) to manufacture export-oriented products or to provide technology not available locally. The climate has evolved considerably from the 1970s when "Indianization" or greater Indian ownership of industry, was on a marked rise--and Coca-Cola and IBM closed their Indian operations as a result. Approvals of foreign collaborations have risen dramatically in recent years, and the United States has led all other countries in the number of ventures.

U.S. Policy and Initiatives. The United States has tried to encourage Indian government officials to continue in liberalizing directions. While the Indian Government's continuing actions indicate commitment to these policies, there are a number of risks involved. Should the Indian economic situation and balance of payments deteriorate seriously, the Indian Government could come under increasing pressure to replace controls and protect the home market.

In an effort to translate this liberalized business climate into the reality of increased commercial relationships, the Commerce Department is attempting to encourage Indian companies to look to the United States for technology as well as equipment. Commerce is also attempting to make U.S. business aware of the changing Indian business climate and the new opportunities it offers.

Secretary Baldrige invited the Indian Minister of State for Science and Technology to visit the United States last May in order that he might become acquainted first-hand with the latest U.S. innovations in his fields of interest. Commerce also was heavily involved in the planning and support of an eleven-city U.S. visit by leading Indian industrialists from the Indo-American Chamber of Commerce last spring. The aim of this mission was to update U.S. business perceptions of India and to stimulate interest in collaborative arrangements with Indian private firms.

Commerce:
R.D.Harding

INDIA - IMPROVED CLIMATE FOR ECONOMIC DEVELOPMENT

I. Background - Development Progress

The Indian economy in 1981/82 demonstrated conditions of continuing growth and stability. Real growth was 5% and in line with the GOI's (Government of India's) target for the current Sixth Five Year Plan. Foodgrain production exceeded by 3% the previous year's level and reached a new record of 134 million metric tons. India appears to have its foodgrain supplies under a sound management system which will assure it food security under all but the most severe drought conditions. Increases were recorded also in industrial production and in exports, the former by 8% and the latter by 11%. Oil imports decreased by 8% as a result of increased domestic oil production, providing relief to the balance of payments deficit. The IMF recently approved a second tranche of its $5.6 billion loan to help meet the balance of payments deficit. Shortages in the supply of industrial products were also significantly reduced as administrative and distribution bottlenecks were ameliorated. On the investment side, both public and private corporation levels increased significantly over prior years. Inflation, which had been on an accelerated course, was decelerated. In short, the Indian economy is healthy and following the right path to further growth and assured stability. The climate it provides for broad-based development efforts is agreeable and conducive to these efforts.

II. Agricultural Development

A. The Spread of Agricultural Technology

The adoption of producer oriented pricing policies, a strong emphasis on research and extension and the introduction of High Yielding Variety (HYV) strains on wheat and rice had a dramatic impact on Indian agriculture. As of 1981, HYV wheat accounted for 80 percent of all wheat acreage and HYV rice accounted for 52 percent of all rice acreage. Wheat and rice have averaged annual yield increases of 1.8 and 1.6 percent respectively since 1970. Cereals production has nearly doubled since 1965.

B. Irrigation

Irrigated areas have increased from 18 percent to 29 percent of net sown area over the past 30 years. However, production is still heavily dependent on the highly variable summer monsoon rains. Continued expansion of the irrigation systems is essential to increasing foodgrain yields and net incomes to farmers. India plans to double its irrigated acreage from 55 million hectares to 107 million hectares by the year 2000. Over the past 3 years, the GOI has shown an increasing awareness that effective irrigation systems require more than proper engineering structures. The GOI has demonstrated a determination to address the managment and institutional constraints on the efficiency of current and planned irrigation systems. Given the availability and quality of U.S. expertise in this area, the GOI is highly receptive to U.S. technical collaboration in developing new institutions for irrigation management, training and technology development.

III. Economic Reforms

India has introduced a large number of policy reforms in response to donor entreaties (especially from the IMF and the IBRD) but also as part of its recognition of the need to introduce major reforms if the Indian economy is to grow at a rate greater then its population. This section will briefly discuss some of the changes made in four sectors of the economy.

A. Prices/Subsidies

An integral objective of the Donor Community and India has been to increase prices administered by the government so as to rationalize the pricing system and reduce the burden on the government's budget. For example, petroleum prices were revised substantially in June 1980, January 1981 and July 1981. Petroleum prices are currently considerably above oil import costs and constitute progress toward the more efficient utilization of gasoline and its conservation. The July 1981 adjustments tripled the price of domestically-produced oil, the first increase since 1975. Also, steel and aluminium prices were raised by about 18 percent and 20 percent respectively; pig iron was raised by 38 percent; fertilizer prices were raised in FY 1980/81, resulting in a savings in the fertilizer subsidy bill of RS 10 billion.

B. Trade

Since 1980 a number of reforms have been introduced to stimulate exports and remove restraints on imports. Specifically, a scheme for 100 percent export - oriented units now permit these units to be set up anywhere in the country with the same duty-free access to imports that normally are provided only in free trade zones. An Export - Import Bank was established in 1980 to finance long-term export credit. A new scheme was introduced to meet the import requirements of the small-scale industries through export houses and the Small Industries Corporation of the State Governments. In addition, forty-seven items were added to the list of items eligible for duty drawback on exports and restrictions on imports have been relaxed to permit increased access to raw materials and intermediate goods. A large number of goods can now be imported under an open general license. Moreover, the GOI has made an explicit commitment to the IMF that it will pursue realistic exchange rate policies.

C. Agriculture

Agriculture contributes 40 percent of India's GNP. The growth of agricultural production, particularly foodgrains, generally has been satisfactory in the past few years. This growth results from a number of factors, including irrigation and HYV, but also from several policy reforms that moved the agricultural sector in the right direction.

--Support prices for foodgrain have been increased by 10 percent for paddy and 11 percent for wheat.

--Official grain stocking efforts have generally been successful and prevented serious disruption to food supplies due to the 79/80 drought. In order to ensure that stock levels are maintained, the GOI imported grains in 1981 and 1982.

D. Private Sector

Policies relating to private sector industry are aimed at encouraging production, investment and economic efficiency. In July 1980, the GOI issued an "Industrial Policy Statement" that permits automatic capacity expansion approval for 19 industries (in addition to the 15 industries that previously had received this approval). At the same time, incentives were established for any unit that is 100 percent export oriented; this includes duty free imports of capital goods and raw materials and concessions in central government exise taxes. In 1981, 14 groups of industries were added to the list of those eligible for specific investment related tax concessions and surcharges on income tax payable by all classes of companies were reduced from 7.5 percent to 2.5 percent. Also, in 1981, the GOI permitted the private sector to establish new power plants to supplement public sector electricity generation.

IV. Role of Foreign Assistance

A. Official Flows

The concessional assistance provided primarily by the members of the World Bank-led India Aid Consortium, and the balance of payments relief from the IMF's Extended Fund Facility (EFF) play very significant roles in agricultural development and in macroeconomic policy reforms.

The major donors in the agriculture sector, the World Bank and the U.S., emphasize increasing the efficiency of irrigated water use through complementary capital and PL 480 Food for Work projects, although their approaches differ. Nevertheless, the technological changes that are being introduced through both donors projects agree and are producing policy changes to improve how irrigation systems are constructed, operated and maintained.

All of the donors with major programs in any agriculture sub-sector, e.g., irrigation, extension, research, are influencing policy changes in that sub-sector, regardless of whether the change has a production, technological, or administrative focus, or a combination of these. To a lesser extent, donors have been able to influence key areas of overall sector policy, such as procurement pricing, subsidies, and food stock levels.

B. Private Foreign Investment

For years, India has been a challenge for foreign business, with profitability rarely greater than eight or nine percent, restrictions on repatriation of profits and dividends, and forced dilution of equity held by foreign-owned firms. The result has been an outflow of investment funds by investors weary of legal disputes and complicated bureaucratic procedures. Recently, however, the Indian position regarding foreign investment has been changing, and a new policy is emerging, primarily due to the country's need for new technology and a severe balance of payments deficit. Despite a number of improvements, however, multinational corporations in general continue to be wary of India's insistence on minority equity ownership for foreign investors and a significant export commitment. U.S. companies view India's efforts with cautious optimism and feel that, although India has taken some measures to make foreign investment more attractive, more could be done.

The United States is the second leading source of foreign investment in India behind the United Kingdom. At year end 1980, the U.S. direct investment position in India stood at $396 million, up 16 percent from $341 million at year end 1979 and up eight percent from its former peak of $367 million in 1975. The United States followed closely by the U.K. and Germany, has emerged as the major supplier of technology. The other sources of technology inflow were Japan and Switzerland, followed by France and Italy. On average around 15 percent of collaboration agreements had some financial implications though the amount of foreign equity investment was extremely small--a total of US $70.6 million in the years 1971-80. US companies again tended to have a relatively higher proportion (22 percent) of financial participation.

In sum, private foreign investment in India has been and continues to be quite small. Since 1980 a sense of cautious optimism has emerged in the U.S. business community regarding new investment opportunities in India. This mood is in direct contrast to the prevailing feeling of frustration evident in earlier years.

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U.S. - INDIA TRADE RELATIONS

DESCRIPTION

Trade has been a dynamic and generally constructive element in our bilateral relations with India. Bilateral trade has nearly doubled in recent years, increasing from $1.5 billion in 1977 to $2.9 billion in 1981. U.S. agricultural exports to India also are significant and have grown substantially -- from $256 million in 1970 to $476 million in 1981. In addition, India is a major participant in the U.S. GSP and has doubled its duty-free shipments under the program from $76 million to $161 million since 1976.

The United States in the past has taken various steps in the trade area to aid India. Specifically,

- We have added 11 products to our GSP eligible list at the request of India.
- We accepted another 3 Indian requests for consideration during this year's GSP product review.
- We have consistently redesignated India on all eligible GSP trade.
- We have not graduated India on any GSP product.
- Specifically at the request of India, we have established certification procedures to allow inclusion of folklore textile products in the GSP.

We can continue to aid India through these and other such measures, but there are considerable difficulties associated with moving too quickly or too far in this direction. Many members of Congress, and in particular those on the House and Senate trade subcommittees, view India as a difficult trading partner which pushes for increased open access to the U.S. market without demonstrating any willingness to open up its own market in return. Many in Congress strongly opposed as too weak the commitment on subsidies which Ambassador Brock signed with the Government of India in 1981. Further, some believe India should be treated as a more advanced developing country and should graduate to some degree from the preferential trade status it now enjoys. Thus, Congress is unlikely to look favorably upon Administration proposals for increased non-reciprocal trade concessions for India.

Further, India's own policies sometimes have complicated our bilateral and multilateral trade relationship. India applies import restrictions against certain U.S. products which have had an adverse effect on our export opportunities there. They also disagree with certain aspects of U.S. administration of its countervailing duty law and have threatened to challenge us in the GATT on those points. Most recently, India has been reluctant to support -- and has indicated that it may even oppose -- the various initiatives which the United States proposes for consideration at the November GATT Ministerial.

However, there are several brighter aspects of our trade relationship which may to some degree counterbalance these negative points. India in recent years has taken steps to liberalize and streamline its overall import regime, a trend which the United States strongly supports. India also has aided U.S. objectives in North/South discussions on trade in UNCTAD and in the GATT by taking positions considerably less strident than many of its G-77 cohorts.

The tenor of U.S.-India trade relations will be affected in considerable measure by India's ultimate policy stance with respect to the U.S. initiatives for the GATT Ministerial. The United States has taken, and continues to take, gradual steps to improve our trade relationship with India, particularly in view of India's import liberalization moves. However, even our limited steps in this direction are made more difficult by India's own policy positions and by the Congressional and domestic criticism they generate. For example, in the subsidy case on industrial fasteners, India refused to provide information which would have enabled Commerce to set the countervailing duty rate at the real level, presumed to be quite small, rather than at the imputed rate of 17.5 percent. India's unwillingness to submit such information placed USTR in a very difficult position when the domestic industry pressed for expedited removal of the products from GSP following Commerce's announcement of its intention to revoke the countervailing duty order on the duty-free fastener items. Ambassador Brock ultimately decided in India's favor by refusing to expedite the GSP review, but his decision would have been considerably easier had the countervailing duty originally been set at the actual rate rather than the inflated rate of 17.5 percent.

Given this general context, it would be extremely difficult domestically for the Administration to propose that the United States institute special trade measures for India's benefit.

Recommendation

That no major package of trade concessions for India be contemplated, although the USG would continue to make individual trade decisions which are beneficial to India, provided that they support U.S. positions in the GATT Ministerial and continue to make progress in liberalizing their import regime, especially in cases where U.S. export interests are affected.

USTR: MCoyle: 9/10/82
395-6813

Cleared by: PAllgeier
DWhitfield